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MACROECONOMIC POLICY QUESTIONS: EXTERNAL DEBT CRISIS AND DEVELOPMENT

The developing country debt situation as of mid-1994

Report of the Secretary-General

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EXECUTIVE SUMMARY

The international debt strategy has been strengthened in recent years and continues to evolve. However, despite persistent national and international efforts, too many countries still face acute debt-servicing problems.

At the aggregate level, the debt indicators have improved significantly in the past dozen years. This is owing in particular to improvement in Latin America. In Africa some - though not all - debt indicators have slightly improved in recent years, but the situation there is considerably worse than in the early 1980s. Indeed, payment arrears of Africa continue to soar.

Numerous countries - the number ranges from 64 to 72, depending on the definition used - still face a debt crisis in the sense that either they are in arrears or they have not been able to fully service their debt recently without special arrangements. While in the last few years, several countries have overcome their crisis, others have fallen into the debt trap.

The very large number of countries with debt problems does not pose a threat to the international financial system any more, as the majority of the large, middle-income, market borrowers have exited the crisis. Helped by the Brady plan, most have regained access to the international private capital markets.

While there is still widespread concern whether the overall degree of relief that the international strategy is able to marshal for low- and middle-income countries is adequate, a further aspect of the international debt strategy is also a concern. For most countries, the current strategy provides relief in a drawn-out series of phased accords and does not provide a one-off arrangement that would reduce debt by the critical mass needed to restore debt-servicing capacity, strengthen the confidence of domestic and international investors, and induce a positive new inflow of resources.

It is to no one's benefit if the situation drags on. The challenge today is to assist all debt-crisis countries on a definitive reform track to reach the critical mass of debt reduction in a timely fashion.

I. INTRODUCTION

1. In 1985, the great majority of heads of State and Government and foreign ministers who addressed the General Assembly expressed their profound concern about the negative impact of the debt crisis on development and international stability. It was stressed at that time that the debt crisis had reached such substantial economic and social magnitudes that it warranted the political attention that the General Assembly could accord. And so, the Assembly became part of the process of building the global consensus on debt.

2. In 1986, the General Assembly thus began to closely monitor the external debt crisis of developing countries, according it a separate item on the Assembly's agenda. The Assembly has since held annual discussions on debt, each of which led to a resolution that was adopted by consensus or by a vote that showed universal or almost universal support within each group of country delegations. The series of Assembly debates revealed the advancing international recognition of the severity of the debt problems of many developing countries, as well as of certain countries that came to be part of a group that is now called the transition economies. The Assembly repeatedly stressed the need for strengthening the international strategy to ameliorate unsustainable external debt burdens.

3. As previous reports to the Assembly on the external debt crisis and development have detailed, the international debt strategy has indeed been strengthened in various ways on a number of occasions. 1/ Based on the outcome of the July 1994 summit in Naples of seven major industrialized countries (the Group of Seven), a new strengthening seems imminent, as the Paris Club considers a more concessional treatment of debt owed to government creditors by the lowest income and most seriously indebted countries.

4. The present report, which was requested in Assembly resolution 48/182, seeks to raise certain questions that the Assembly may wish to discuss in its 1994 review of external debt and development. At this juncture, a key question is whether or not the international policy process has now almost run its course. We have had a cooperative international strategy for over a decade and it has evolved to include greater concessions for the debtor countries. With pending improvements in Paris Club terms, is the strategy more or less now in its final form? Do we need additional tools? Do we need to further strengthen the ones now in place?

5. Some countries whose debts were restructured in recent years under the international debt strategy have re-entered the financial markets and neither their new creditors nor their people believe that they are still "debt-crisis" countries. Other countries are clearly still mired in debt disasters and the call by the leaders of the Group of Seven to improve Paris Club terms for some of these countries shows that at the highest political level the major creditors have acknowledged the persisting difficulties. But is the problem really over in the countries with renewed market access and will the new treatment to be adopted by the Paris Club solve the problem? Are the current terms sufficient for countries that are neither so important nor so poor as to receive special attention? And is it possible to be sanguine about the continued success of the

countries that have thus far shouldered high debt-servicing burdens without slipping into arrears and joining the ranks of the problem debtors?

6. The analysis that follows indicates that the road ahead is not fully mapped as yet. The international debt strategy seems to require a further strengthening that is suggested in the report's conclusion. The analysis draws heavily on the work of the International Monetary Fund (IMF) and the World Bank, as well as that of the United Nations Conference on Trade and Development (UNCTAD).

II. THE STATUS OF THE INTERNATIONAL DEBT STRATEGY

7. After more than a decade of initiative and experiment, trial and error, success and failure, the international debt strategy has come to embody a host of policies and considerations. Not all heavily indebted countries have formally availed themselves of the strategy, as it requires accepting a complete package; but even the countries that resolved aspects of their debt problems independently - most notably Brazil, in settling with its banks in 1994 - have worked within the general framework of the strategy. The strategy does not exist as a codified set of principles and procedures and a certain ambiguity has probably smoothed international consideration of the issue. It seems necessary for any assessment, however, to try to delineate what the debt strategy has come to entail.

8. One overarching principle of the strategy seems to have been applied from the beginning: whatever combination of external and internal shortcomings and unfilled expectations brought about the external debt crisis in any given country, that country had to adjust to the international economic environment to achieve a financially sustainable rate of economic growth. Broader economic reforms in the international arena might well be sought, but the debt strategy in practice would itself be more limited in scope. A process of economic adjustment was thus required by each debt-crisis country; but since the country's debt-servicing obligations exceeded what it could manage, a process of debt restructuring was also required.

The domestic adjustment package

9. The usual policies to bring about domestic economic stabilization and adjustment included standard macroeconomic management components, as well as shifting to more liberal trade and investment regimes. Prices were meant to increasingly reflect actual opportunity costs, making local production more efficient and exports more competitive. One problem cited in many debtor countries was a low investment rate (and in some cases, a low domestic saving rate). Policy reforms were expected to affect this dimension too, as they would increase the country's attraction as a location for investment, both by domestic entrepreneurs and by foreign direct investors.

10. One aspect of the adjustment process, however, was not fully recognized until some time passed. No matter how desirable the adjustment process was, it often set in motion major social changes and the most vulnerable groups were, not surprisingly, the least able to protect themselves during the process.

Thus, policy also began to address the question of social safety nets and ask - if not always answer adequately - how to ameliorate the impact of the crisis on the poorest.

The debt-restructuring package

11. The external financial side of the policy package has aimed to reach a durable solution to the excessive debt-servicing obligations. Initially, however, the international strategy treated the debt crisis in many countries as a short-term liquidity problem, set off by unusually high international interest rates and recession-induced low prices of commodities. But longer-run changes in the world economy undid some countries and the cumulative consequences of unsustainable domestic policies undid others, and in time the debt question came to be seen as a solvency issue. In several cases, the early strategy even aggravated the problem by arranging new lending to help finance existing debt servicing, which mainly postponed a more severe debt-servicing crisis.

12. Since the late 1980s, the international debt strategy has encompassed a variety of options that were made available to different categories of countries for restructuring the debt-servicing obligations on several forms of debt. Relief has been provided through different sets of negotiations that, as a rule, were intimately tied to domestic adjustment packages that were supported by official financing packages. The creditors whose loans were the primary targets for debt-service rescheduling and reduction fell into two groups, international commercial banks and official suppliers (or guarantors) of export credits and other loans. 2/

13. Much attention has focused, in particular, on the terms for restructuring commercial bank debt in negotiations between the Governments of individual debtor countries and the advisory committees of their commercial bankers (sometimes called the London Club). The advisory committees negotiate a set of options with a debtor Government from which the creditor banks that they represent choose. Settlements have come to entail a fairly standard, "expanded menu" of options, of which most more or less reflect the discount from face value of the debt, as traded in the private secondary market that emerged as banks first exchanged and then sold their claims on developing and transition economies. As an encouragement to the banks to accept lower repayment obligations from the debtor, IMF and the World Bank have offered loans to help finance partial guarantees of the restructured debt instruments. In some cases, the international community has also helped the Government of the debtor country to buy back its bank debt at a discount, and some innovative schemes have evolved wherein non-governmental organizations have purchased debt instruments and swapped them with debtor Governments in exchange for pledges to use certain domestic resources for mutually desired environmental and social purposes. For the most part, the evolution of the treatment of commercial bank debt in the international debt strategy in recent years has entailed extending the current menu of options to additional debtors under terms that have become more and more standardized.

14. Most of the debt-servicing obligations to official bilateral creditors have been restructured in the Paris Club. There, representatives of official creditor institutions have developed a set of general treatments that are

applied on a case-by-case basis to individual countries through negotiations that determine how much debt servicing will be affected, usually stated as the obligations falling due during a "consolidation period" on debts that were incurred before a "cut-off date", both of which have to be agreed. Except in very special cases, Paris Club agreements give rather short-run relief - now commonly two years rather than one - on the eligible part of the debt owed to the Paris Club creditors. The different classes of treatment are offered to countries according to their income level, with the most concessional treatments having been given to low-income countries, albeit with exceptions at politically important moments for certain other countries.

15. The most concessional treatment - which the Paris Club may improve upon before the year ends - accords "enhanced Toronto terms" to the poorest and most-indebted countries. 3/ Under these terms, creditors may reduce the debt-servicing obligations falling due within the consolidation period by either forgiving principal or reducing the interest rate, for a total concession of about half the amount due. However, as not all creditors were authorized to permanently forgo debt-servicing claims, there was also a non-concessional option in which the debt could be rescheduled over 25 years with a 14-year grace period (interest on the deferred amounts remaining payable during the grace period). Besides these terms, a group of lower middle-income countries can benefit from longer-term rescheduling of debt servicing than other countries, but with no write-off of principal or interest. 4/ Outside the Paris Club, there have also been important instances of unilateral cancellation of military, official-development assistance and other debt owed by least developed and other countries.

16. No formal debt restructuring exists for debt owed to the multilateral institutions, although countries may find that the disbursements of concessional, multilateral loans and bilateral assistance may help to service outstanding multilateral debt. Programmes exist so that countries that have accumulated substantial arrears to the multilateral banks or IMF can work out their difficulties in collaboration with these institutions. Although the latter are prohibited from extended new loans while arrears remain, a group of bilateral supporters can extend financial assistance and help repay the arrears. In a unique instance, the World Bank established a mechanism in which the International Development Association (IDA), the Bank's concessional lending arm, helps to refinance the interest cost of outstanding non-concessional Bank loans of countries that have become eligible for IDA funding. In general, however, multilateral debt servicing is one of the "fixed costs" that have to be factored into the gross, external, financial needs that donors and creditors are asked to meet in aid consortia, round tables and other efforts.

17. In sum, debt-restructuring activity has directly or indirectly touched most of the types of debt that developing countries have incurred. But that is not necessarily the same as returning the countries to sustainable debt-servicing situations.

III. HAS THE STRATEGY SOLVED THE DEBT CRISIS?

18. Whether one concludes the debt crisis is over or not depends on how it is defined. Most would view an individual country as having an external debt crisis if it fails to pay interest or repay principal on its foreign debts on schedule. If many countries from different regions of the world start failing to service their debts at about the same time, then that phenomenon can be defined as an international debt crisis. This is precisely what happened in the early 1980s as major industrialized countries slipped into deep recession, dollar interest rates surged upward and commodity prices dropped precipitously. While a growing number of countries had been experiencing debt-servicing difficulties even before Mexico suspended debt payments to commercial banks in August 1982, the Mexican moratorium is widely regarded as the beginning of the Third World debt crisis. Within a year of the Mexican default, what began as the debt problems of a small group of countries became a full-blown international debt crisis, as debt-servicing failures and reschedulings spread rapidly among the developing countries.

19. A specific aspect of this development especially worried the international community: the major troubled debtors were large, middle-income economies that owed the bulk of their debts to the top commercial banks of the key industrialized countries. The debts were alarmingly large relative to the banks' capital and posed a threat to the international banking system. The officials managing the crisis envisaged its successful resolution in terms of attaining essentially two goals. One was to eliminate the threat to the international banking system. This required giving the banks sufficient breathing time to enable them to build up their capital base and absorb losses from the bad debts without undermining their viability. The other was to help the major developing-country debtors restore their debt-servicing capacity, regain their creditworthiness, and thereby renew access to private capital markets. This, of course, required countries to undertake successful macroeconomic stabilization programmes, carry out structural reforms and attain non-inflationary economic growth with a sustainable external balance.

20. To some observers, the failure of the market borrowers to service the massive amounts of their commercial bank debt and the resulting threat they posed to the international banking system were what constituted the developing-country debt crisis. Consequently, restoration of creditworthiness and market access of these market borrowers and eliminating the threat to the viability of the creditor commercial banks were seen as defining conditions for ending the crisis. Indeed, as most of the top market borrowers were in Latin America, the international debt problem was often referred to as the Latin American debt crisis.

Debt indicators at the aggregate level

21. When the debt crisis erupted and quickly spread, the developing countries as a whole seemed to be in crisis or threatened by crisis. Actually, not all countries were seen as vulnerable in the early 1980s, as the payments surpluses and net foreign wealth of several major petroleum exporting countries, mainly in the Middle East, had been newly swollen by the ascent of oil prices in 1979 and 1980. But it seemed that the crisis could engulf all the rest, namely, the

"capital-importing developing countries". Analysts thus posed questions about this aggregate. How large was the total debt at risk? Was it more than the developing countries could service?

22. The answer was that the capital-importing countries owed over $800 billion (see figure 1). This was more than twice the value of exports of goods and services (see table 1), which was a common rule-of-thumb at the time to signal impending debt difficulties. The overall ratio of debt-servicing to export earnings was almost 30 per cent. Another rule-of-thumb was that the debt-servicing ratio should be under 25 per cent (although before the debt crisis began, many analysts put it in the range of 15 to 20 per cent). Thus, it seemed that the capital-importing developing countries as a whole were very much at risk. Latin America alone accounted for 44 per cent of the total debt. Its debt was three times as large as its exports and its debt-servicing ratio was over 40 per cent.

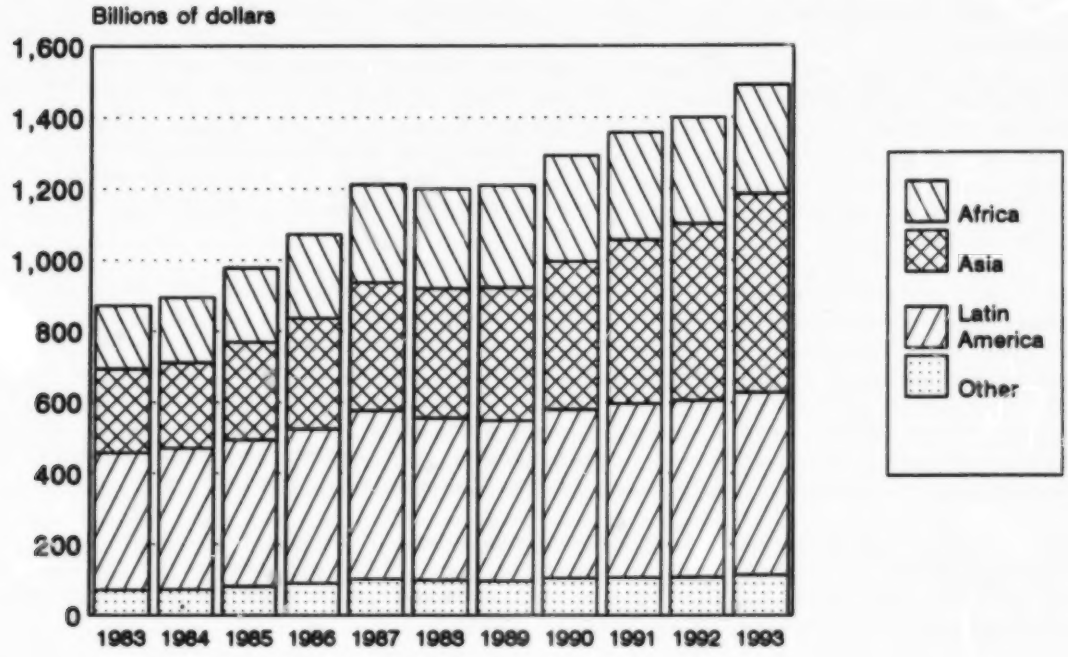
23. Monitoring the debt crisis became, in part, monitoring the behaviour of these aggregates. By 1993 the total debt reached about $1.5 trillion, 71 per cent more than it had been in 1983, but Latin America's share of the total had dropped below 35 per cent. Indeed, total debt had peaked in 1987 and did not start rising again until 1990. Latin America's debt had actually fallen in 1988 and 1989. Other countries were borrowing more heavily, in Africa and Asia and under very different circumstances, and indeed the heterogeneity of the developing-country debt situation became increasingly salient.

24. Today, based on such indicators, the overall debt situation of the developing countries seems much improved. By 1993, all the major ratios were below the 1983 level at the aggregate level and Latin America's ratios were substantially below what they were in 1983.

25. The African indicators, however, showed a less sanguine situation. Although all Africa's key ratios had begun to fall, most were still substantially higher than in 1983. Moreover, in the sub-Saharan region (defined to exclude Nigeria and South Africa, which, because of their large size, would otherwise overwhelm the data of the other countries), the ratios of debt to GNP and debt to exports had only recently stopped rising and each was far higher than in 1983.

26. One indicator that looked encouraging on the surface was Africa's debt-servicing ratio, which had fallen below the 1983 level, and in the sub-Saharan region it had dropped more than one third below what it had been. Yet this, too, entailed a troublesome result. Although Africa receives an increasing share of its credit on concessional terms, the improvement in the debt-servicing ratio was also the result of growing arrears in interest and principal payments. Indeed, sub-Saharan arrears were estimated to have reached $40 billion by the end of 1993, or over one quarter of the area's total debt. 5/

Figure 1. Foreign debt of the capital-importing developing countries, 1983-1993



Source: United Nations, *World Economic and Social Survey, 1994* (E.94.II.C.1 and Corr. 1).

Table 1. Debt indicators for capital-importing developing countries, 1983-1993

(Percentage)

	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993[a]
						Ratio of external debt to GNP					
All countries	45.4	44.4	49.3	52.7	54.9	44.1	45.0	44.1	45.1	43.3	43.0
of which:											
Latin America	62.7	62.7	64.4	66.6	68.6	43.5	50.9	46.6	44.9	41.7	40.8
Africa	49.3	51.2	59.6	67.9	76.3	77.0	79.0	74.3	77.4	72.6	71.4
Asia	25.9	23.9	28.1	30.7	31.1	27.0	25.2	26.8	28.3	28.4	29.4
Memo items											
Sub-Saharan Africa	60.5	66.9	78.8	78.4	90.8	92.9	97.4	103.9	107.1	105.4	107.3
"Baker-15"	56.7	57.1	58.7	62.3	66.1	56.0	48.4	44.3	43.4	40.7	41.9
						Ratio of external debt to exports[b]					
All countries	217.1	206.0	228.8	264.9	255.3	223.0	204.3	196.1	189.8	182.8	184.9
of which:											
Latin America	309.4	291.3	320.5	390.9	384.1	327.0	291.5	279.0	280.2	276.9	267.7
Africa	204.0	204.9	234.1	295.3	309.4	297.0	283.9	249.4	239.7	231.5	233.6
Asia	108.5	97.8	112.9	116.4	104.1	86.0	78.4	78.1	75.0	75.0	80.9
Memo items											
Sub-Saharan Africa	223.6	222.9	269.1	308.7	343.7	335.4	330.5	337.9	360.2	368.4	362.5
"Baker-15"	294.8	276.9	295.3	357.1	350.8	299.0	267.0	245.4	248.4	249.8	248.0
						Ratio of debt-service to exports[b]					
All countries	27.7	28.0	29.4	32.3	29.5	28.1	24.6	22.2	20.2	20.3	19.9
of which:											
Latin America	40.8	38.4	37.7	43.6	38.1	39.8	33.2	27.2	26.3	30.3	29.9
Africa	23.8	28.7	28.3	32.1	26.3	28.6	26.6	25.8	23.3	22.8	21.6
Asia	13.2	13.0	16.2	16.0	15.8	12.1	10.6	9.9	8.6	8.5	8.6
Memo items											
Sub-Saharan Africa	20.0	19.7	22.2	25.4	23.4	22.9	19.5	18.0	17.4	14.9	12.7
"Baker-15"	41.8	40.3	37.9	42.9	37.1	39.0	33.5	26.9	26.0	29.6	28.0

Source: United Nations, World Economic and Social Survey, 1994 (United Nations publication, Sales No. E.94.II.C.1 and Corr. 1), table A.36.

Note: Country groupings are those of World Economic and Social Survey, 1994 (sub-Saharan Africa excludes Nigeria and South Africa; the "Baker-15" are those countries that were subject to special policy attention under the international debt strategy proposed by then-Secretary of the Treasury of the United States, James A. Baker III, in a speech to the 1985 Annual Meetings of IMF and the World Bank in Seoul, Republic of Korea).

[a] Preliminary estimate.

[b] Exports of goods and services, primary incomes and workers' remittances.

27. In sum, although aggregate data are a common and straightforward way to measure a situation that pertains to a large number of countries, the story embodied in aggregated data necessarily gives the most significance to the largest actors. As Africa's data suggest, it is also important to supplement an analysis at the aggregative level with one that looks at the debt problem in a way that treats each country the same, large or small.

Debt indicators at the country level

28. A different approach to measuring the severity of the international debt crisis would be to simply count the countries that are in active crisis or whose debt situations might be deemed fragile. Both the World Bank and IMF have developed criteria for defining difficult debt situations and have categorized countries by their criteria. The conclusion of an analysis of these data has to be quite sobering: the countries with fragile or difficult debt situations are extremely numerous, as they were in the late 1980s.

29. One source of the evidence is the World Bank's list of severely indebted countries, as reported in its annual publication, World Debt Tables. 6/ Three observations emerge from a comparison of the most recently published list with the first publication of a comparable list, which appeared at a time when the debt crisis was widely considered to be still at its height (see table 2). First, both lists are very long: the number of reporting countries identified as severely indebted (48) in the Bank's World Debt Tables, 1993-94 is higher than the number classified as severely indebted (45) in its World Debt Tables, 1989-90, published four years earlier. 7/

30. Secondly, while most of the countries classified as severely indebted during the late 1980s are still stuck in the same category, the situation is by no means a static one. There is considerable turnover in the membership of the club of heavily-burdened debtors. Since the late 1980s, 12 countries have left the group of severely indebted countries while 15 other countries that were not previously so categorized have been added to the list. 8/ The debt crisis thus involves a large group of countries whose composition is in a state of flux: after having spread like an epidemic during the 1980s, debt-servicing difficulty has apparently evolved into a chronic but curable disease - as some patients recover, it claims new victims.

31. Thirdly, a common view that excessive indebtedness is largely limited to Africa's low-income countries is also contradicted by evidence. Based on the situation in 1990-1992, which was the basis for the most recent list, 19 out of the 48 severely indebted countries were middle-income debtors and most of those were not in Africa. These middle-income countries spanned across four regions of the world. Not surprisingly, many of them were from Latin America and the Caribbean (eight countries) and Africa (six countries). The rest were in West Asia (two countries) and eastern Europe (three countries). The problem of over-indebtedness is thus not limited only to low-income countries. Neither is it concentrated in a single region; its scope, affecting so many countries, both developing and transition economies from all income groups, makes it an international concern of continuing importance.

Table 2. Countries classified as severely indebted by the World Bank[a]

World Debt Tables 1989-90 (Data of 1988)		World Debt Tables 1993-94 (Data of 1990-92)	
Severely indebted low-income countries (SILICs)[b]	Severely indebted middle-income countries (SIMICs)[b]	Severely indebted low-income countries (SILICs)[c]	Severely indebted middle-income countries (SIMICs)[c]
Benin, People's Republic of	Argentina	Burundi	Albania
Burundi	Bolivia	Central African Republic	Algeria
Comoros	Brazil	Egypt, Arab Republic	Angola
Equatorial Guinea	Chile	Equatorial Guinea	Argentina
Ghana	Congo, People's Republic of	Ethiopia	Bolivia
Guinea	Costa Rica	Ghana	Brazil
Guinea-Bissau	Côte d'Ivoire	Guinea-Bissau	Bulgaria
Guyana	Ecuador	Guyana	Cameroon
Kenya	Honduras	Honduras	Congo
Liberia	Hungary	Kenya	Côte d'Ivoire
Madagascar	Mexico	Lao PDR	Ecuador
Malawi	Morocco	Liberia	Jamaica
Mali	Nicaragua	Madagascar	Jordan
Mauritania	Peru	Mali	Mexico
Mozambique	Philippines	Mauritania	Morocco
Myanmar	Poland	Mozambique	Panama
Niger	Senegal	Myanmar	Peru
Nigeria	Uruguay	Nicaragua	Poland
Sao Tomé and Principe	Venezuela	Niger	Syrian Arab Republic
Sierra Leone		Nigeria	
Somalia		Rwanda	Cuba[d]
Sudan		Sao Tomé and Principe	Iraq[d]
Tanzania, United Republic of		Sierra Leone	
Togo		Somalia	
Zaire		Sudan	
Zambia		Tanzania, United Republic of	
		Uganda	
		Zaire	
		Zambia	
		Afghanistan[d]	
		Cambodia[d]	
		Viet Nam[d]	

Source: World Bank, World Debt Tables 1989-90, vol. 1 (Washington, D.C., World Bank, 1989); and World Debt Tables 1993-94, vol. 1 (Washington, D.C., World Bank, 1993).

[a] With the publication of World Debt Tables 1992-93, the World Bank changed its methodology of classifying countries by the level of debt-servicing capacity. However, the critical ratios of the new indicators were chosen so as to cause minimal discontinuity to the list of countries identified as severely indebted or moderately indebted. For details, see World Debt Tables 1992-93, pp. 127-129.

[b] Countries for which three of four ratios for 1988 are above critical levels. These ratios and their critical levels are: debt to GNP (50 per cent), debt to exports of goods and services (275 per cent), accrued debt service to exports of goods and services (30 per cent), and accrued interest to exports of goods and services (20 per cent). Countries are classified as low-income if their 1987 GNP per capita is no more than $480, and as middle-income if their 1987 GNP per capita is more than $480 but less than $6,000.

[c] Countries in which either of two ratios for 1990-92 is above critical level. These ratios and their critical levels are PV to GNP (80 per cent), and PV to exports of goods and services (220 per cent), where PV is the present value of total scheduled debt service. Countries are classified as low-income if their 1992 GNP is no more than $675, and as middle-income if their 1992 GNP per capita is more than $675 but less than $8,350.

[d] Countries that did not report their debt statistics to the World Bank, but which were classified by the Bank, based on other sources. These countries are not included in the enumerations discussed in the text and are shown here for completeness.

32. An additional fact is noteworthy - the high degree of indebtedness of the so-called "Baker-15" countries. These countries were singled out in 1985 for special attention by then-Secretary of the Treasury of the United States, James A. Baker, III. 9/ The special concern arose from the top priority that the official international debt strategy initially gave to rescuing the vulnerable centrepiece of the world's banking system, the large, "money-centre" banks. Great urgency was thus given to restoring the debt-servicing capacity of the large debtors that owed the bulk of their external debts to these banks. The Baker Plan did try to help these countries, but managed mainly to deepen their debt crisis by applying a liquidity solution to what was increasingly realized to be a solvency problem. The subsequent "Brady plan" (named after then-Secretary of the Treasury of the United States, Nicholas F. Brady, who proposed it in 1989), also directed special attention to the Baker-15 countries, as well as to other heavily indebted countries, and became the core of the international debt strategy in so far as it treated the commercial bank debt of middle-income countries.

33. But the debt crisis is still not over even for the members of this group. Half a decade after the Brady plan was unveiled, five out of the Baker-15 countries have not returned to normal and full debt servicing (Côte d'Ivoire, Ecuador, Nigeria, Peru and the former Yugoslavia). This failure is rooted largely in the policies and politics of the countries, although the agreements completed under the Brady plan have accorded less relief on a net basis than might have been expected at first. Nigeria is a case in point. In January 1992, Nigeria signed a Brady agreement, but with continuing domestic economic and political difficulties, Nigeria's debt-servicing capacity was not restored and the country went deeper into arrears.

34. Two Baker-15 countries that are still mired in debt are in Latin America. Peru - a country more populous than Venezuela and Chile - has yet to fully service its external debts. Peru began talks with its commercial bank creditors in September 1993, but agreement has not yet been concluded. Ecuador, the other country, signed a Brady agreement in principle in May 1994. But the prospects for restoring debt-servicing capacity remain uncertain and completion of the agreement is contingent on meeting the policy targets set in a two-year stand-by loan from IMF. Indeed, a new Paris Club rescheduling is also contingent on maintaining the adjustment targets, as well as new loans from multilateral and other official creditors. Ecuador has a critical need for such credits. They would assist in financing the up-front costs of the Brady deal and for servicing the heavy debt burden that will remain even after restructuring is completed according to the terms of the debt agreement.

35. It is striking that in the 1993-94 World Debt Tables, the World Bank still classified nine of the Baker-15 countries as severely indebted and five as moderately indebted (see table 3). 10/ Since the debt indicators are calculated from 1990-92 data averages, they may well be overestimating the degree of indebtedness of some of them by failing to incorporate the positive impact of debt-reduction exercises completed since then. But correcting for this backward-looking bias is not likely to brighten the picture drastically. For example, Brazil, Argentina, Peru, Côte d'Ivoire and Nigeria will still likely be classified as severely indebted, and few are likely to move to the group of less-indebted countries.

Table 3. The World Bank's most recent classification of the "Baker-15" countries[a]

Severely indebted low-income countries (SILICs)[b]	Severely indebted middle-income countries (SIMICs)[b]	Moderately indebted middle-income countries (MIMICs)[b]
Nigeria	Argentina	Chile
	Brazil	Colombia
	Bolivia	Philippines
	Côte d'Ivoire	Uruguay
	Ecuador	Venezuela
	Mexico	
	Morocco	
	Peru	

Source: World Debt Tables, 1993-94, vol. 1 (Washington, D.C., World Bank, 1993).

[a] For definition of country grouping, see table 1.

[b] SILICs and SIMICs were defined in table 2. Using the same terminology, a country is classified as moderately indebted if it is not classified as severely indebted, that is, its PV-to-GNP ratio does not exceed the critical value of 80 per cent and its PV-to-exports ratio does not exceed the critical value of 220 per cent, but either ratio is 60 per cent or more of the critical value. The ratios are calculated for 1990, 1991 and 1992, and the three-year average for 1990-92 is used.

36. This observation highlights the nature of the Bank's classification criteria. Countries can be seen as having solved their debt problem in the eye of the market, as might be said of Argentina and Brazil, but might still be classified as severely indebted. The Bank's measure of the degree of indebtedness aims to help evaluate a country's long-term, debt-servicing capacity and thus the potential for future debt difficulties. But it does not tell us whether or not a country is currently failing to service its debt. Thus, while many of the countries classified by the Bank as severely indebted are also currently experiencing debt difficulties, others are not. For example, the Bank still classifies Mexico as a severely indebted country. But Mexico put the debt crisis behind it in 1990 by restructuring its bank debts within the framework of the Brady plan, and it has since become one of the most sought-after hosts of foreign private capital in Latin America.

37. One clear-cut indicator of a country's failure to service its debt - and thus its being in a debt crisis - is the accumulation of payments arrears, because arrears are nothing but the direct result of debt-servicing failure. Arrears are, however, not the most comprehensive indicator of debt-servicing difficulty: a country can anticipate potential problems, refinance its debt and avoid being forced into arrears. Until its recent difficulties, for example, Algeria evaded a debt crisis in this way. But even so, the existence of arrears as an indicator confirms that the debt problem was no less pervasive in its scope in the early 1990s than in the latter 1980s: according to the World Bank's 1993-94 debt tables, the number of countries incurring arrears increased from 72 in 1987 to 75 in 1992, the latest year for which the data are available. 11/

38. As a number of countries have reached agreements with their creditors since 1992, some data adjustments are necessary to portray a more accurate picture of where things stand in the summer of 1994. The 1992 data included eight countries that subsequently restructured their debts, which they are now servicing without difficulty (Argentina, Bolivia, Brazil, Colombia, Costa Rica, the Philippines, Poland and Venezuela). They have also fully or nearly eliminated their arrears. But during the same period, four new countries began accumulating arrears. Three of them are transition economies: Albania, Bulgaria and the Russian Federation. The other newcomer is Gabon. In addition, Algeria - which had no arrears during the 1987-1992 period - needed to obtain a Paris Club rescheduling in June 1994. Once these adjustments are made to the number of countries in arrears as of 1992, 72 countries turn out to have been still experiencing debt-servicing difficulties in mid-1994. By this counting, the number of problem countries thus appears to have changed little since 1987. What has changed instead are the names of some of the entries to the list (not to mention the total amount of debt carried by the countries on the list).

39. The counting of debt-crisis countries based on World Bank data can be supplemented by a review of the group of countries that IMF classifies as "countries with recent debt-servicing difficulties". The category, drawn from the list of countries that IMF classifies as developing countries, includes 72 countries that have incurred arrears or entered into rescheduling agreements on their official or bank debts during the period 1986-1990. 12/ Since 1990, however, 10 countries from this group have restored their debt-servicing capacity while at least two countries that IMF classifies as developing

countries and that serviced their debts on schedule during 1986-1990 have subsequently failed to do so (Algeria and Kenya). According to this calculation, therefore, the number of developing countries in debt crisis has declined from 72 during the height of the debt crisis to 64 by mid-1994.

40. Of these 64 countries, 34 are low-income countries (as classified by the World Bank). They include countries that have recently become unable to fully service their external debts, as well as those that were unable to restore their payments capacity even after their debt-servicing burden had been alleviated (in many cases repeatedly) through rescheduling and debt reduction.

41. A key feature of the group, which might be called the debt-distressed, low-income countries (DDLICs), is its heterogeneity. The countries differ widely in terms of population size, level of indebtedness and debt-servicing capacity. Population varies from 108 million in Nigeria, 62 million in Egypt and about 53 million in Ethiopia, to about 4 to 6 million in Benin, Burundi, Guinea, Honduras and Sierra Leone, to less than a million in Comoros, Equatorial Guinea, Guyana and Sao Tomé and Principe. 13/ Given the huge differences in population size, it is no surprise that the amount of debt also varies widely among the DDLICs. At one end of the spectrum, the end-1992 stock of debt ranged from $40 billion (Egypt) to $31 billion (Nigeria) to $16 billion (Sudan) to $11 billion (Nicaragua). At the other end are countries whose external debt in 1992 was less than $1 billion - Central African Republic ($900 million), Equatorial Guinea ($200 million), Guinea-Bissau ($600 million) and Sao Tomé and Principe ($200 million).

42. The debt-servicing capacity of the DDLICs differs widely as well. The ratio of present value of the end-1992 stock of debt to export earnings ranges from 180 per cent for Egypt to more than 2,500 per cent for Nicaragua, Somalia and Sudan. In other words, the payments capacity within this group of debt-distressed and severely indebted countries varies by a factor of more than 10 - some severely indebted countries are much more severely indebted than others. In between these extremes, the debt-to-exports ratio varies from 200 to 300 per cent for eight countries, from 500 per cent to 1,000 per cent for six countries, and over 1,000 per cent for two countries (Sao Tomé and Principe and Mozambique).

43. All in all, looking beneath the aggregate debt indicators for standard geographical groupings of countries has led to four major conclusions: (a) a very large number of countries - between 64 and 72, depending on how the enumeration is made - were still experiencing serious debt-servicing difficulties in mid-1994; (b) about half of the debt-crisis countries were low-income countries, and about half were middle-income countries; (c) the total number of problem countries has hardly declined since the height of the debt crisis; but (d) the nature of the crisis has changed remarkably, as most of the leading market borrowers have fully restored their debt-servicing capacity and regained market access. The latter also resulted in a massive reduction in the aggregate stock of value-impaired debt.

44. It is most sobering, however, that out of a group of 72 developing countries that, by IMF accounting, were enmeshed in debt-servicing difficulties during the second half of the 1980s, almost 90 per cent continued to experience

persistent debt difficulties in the 1990s. Most of these countries (including several from Latin America) are smaller and poorer than those that have resolved their debt problems.

45. In sum, the number of countries experiencing debt difficulties and their geographical diversity have not changed dramatically since the 1980s. What has changed instead is the character of the crisis: the majority of the top market borrowers have exited the crisis; so today's problem debtors caught in the vicious cycle of debt and development crisis are mostly - but not exclusively - indebted mainly to official creditors, both bilateral and multilateral. The amount of non-performing loans on which the commercial banks still retain claims remains significant, though the viability of commercial banks are no longer threatened.

IV. A MISSING ELEMENT IN THE INTERNATIONAL STRATEGY

46. While the international community can point to the considerable progress in terms of the wide range of measures adopted for debt and debt-service reduction of commercial bank debt, Paris Club debt and even - albeit to a more limited degree - multilateral debt, the continuing extent of the debt difficulties of developing countries remains a cause for concern. Something seems to be missing from the international debt strategy because so many countries continue to have so much difficulty in extracting themselves from its grip. Their high-level officials still spend a great deal of time on cooperatively managing what are ultimately unserviceable obligations.

47. One difficulty that has been a focus of earlier reports on the external debt crisis and development is the general underestimation of the amount of debt relief needed to eliminate the debt overhang. The increasing degree of relief over the years bears witness to that difficulty. Indeed, recent proposals for more formal mechanisms to restructure multilateral debt have grown out of concern that even the most concessional measures available for the lowest-income countries from Paris and London Clubs would not adequately reduce their total debt. 14/ And while the new steps expected in the Paris Club will help to address this problem for eligible countries, the question will remain for other countries, and perhaps even for certain of the eligible ones.

48. There is a second difficulty in the international strategy, however, that is becoming increasingly salient as the international community arranges for ever deeper cuts in the levels of debt and debt servicing. The standard practice has been to arrange a sequence of debt relief measures that is made effective in stages, generally tied to progress in implementing internationally supported economic adjustment programmes. Debt relief can thus be phased over several years (although commercial banks have increasingly sought agreements that wrap up their outstanding claims to reduce the time that their resources remain tied up in uncertain credits). The source of the difficulty seems to reside in the way debt relief measures are linked to adjustment measures, as though debt relief were a reward for responsible policy-making (and, to a degree, good fortune in terms of international economic developments), rather than a recognition that the debts are largely uncollectible.

49. This is not an argument for blanket debt relief, nor is it a criticism of the case-by-case approach to awarding relief. It is also not to say that the debt overhang is always the binding constraint on reaching stability and growth. Many of the countries in debt difficulty are suffering from a generalized development crisis in which the debt problem is more of a symptom than a cause of the overall economic situation. Elimination of all the external debt in such cases would not put such countries back on a path of sustained economic growth and development.

50. The critique is rather in how the debtor's adjustment and the international community's debt relief programmes are linked. The benefits of debt relief do not increase linearly with the amount of debt servicing reduced; they materialize when debt reduction exceeds a critical mass. The focus has been on the international cash flow during adjustment, reducing debt servicing as part of a financing package that aims to yield a positive net transfer of resources. In many cases, however, the alternative to debt relief has included a more rapid accumulation of arrears and so the cash-flow consequences of formal relief are not necessarily large. Arrears, however, add to the debt overhang and investors may legitimately be concerned in such cases about their access to foreign exchange and the Government's ability to move over time to a more and more liberalized payments regime.

51. As Governments increasingly distance themselves from economic activities that can also be undertaken by the private sector, economic adjustment programmes mainly seek to set the appropriate economic, legal and regulatory conditions, "get the prices right" and bolster infrastructure, both physical and human capital. Dynamic economic recovery and growth, however, require an additional component, namely, surging private investment, first domestic but also foreign, and both of these require the confidence that a debt overhang impedes. 15/

52. The proposal, in other words, is that the international community address the question of the full stock of debt at one time when it seeks to assist a country on a definitive reform track. Countries would receive deep and once-for-all debt reduction (not phased over time) in an effort to exceed the critical mass in a timely fashion.

53. The proposal is less than revolutionary: the Paris Club is poised to make its contribution as it begins to consider "the matter of the stock of debt" in subsequent rounds of relief for countries that qualify for the enhanced Toronto terms. The World Bank calls for such an approach to be applied to its SILIC group:

> "... The need for debt stock reduction in these countries is now widely accepted. It is equally important that the design of precise mechanisms take into account the wide variation in indebtedness and the reduced uncertainty, particularly for SILICs pursuing reform policies, that would come from addressing the entire debt stock at one time" (emphasis added). 16/

IMF makes a comparable call:

> "... Where economic management does improve substantially, sustained inflows of external assistance will be important to help put these [low-growth countries, especially the low-income] countries on a stronger growth path. For countries with unsustainable debt burdens, timely and realistic debt-reduction agreements are also essential" (emphasis added). 17/

54. In the Fund and the Bank, the analysis underlying the call for "timely and realistic debt reduction" focuses on the lowest-income countries. It is true that the low standards of living in these countries warrant the special attention of the international community. But if the argument underlying the call is correct, it applies equally to the debt-constrained middle-income countries. As the analysis of this report indicates, the debt situation remains a major difficulty across a wide range of countries and bolder steps as advocated above are necessary.

Notes

1/ See the following reports of the Secretary-General: A/41/643, A/42/523, A/43/647, A/44/628, A/45/656, A/46/415, A/47/396 and A/48/345.

2/ A major category of the other loans is official development assistance (ODA). In 1978 the international community had already called upon Governments that had provided ODA in the form of subsidized credits to retroactively reduce the terms of the credits payable by least developed and other low-income countries (Trade and Development Board resolution 165 (S-IX)). Following that, substantial ODA debts were written off in the late 1970s and early 1980s and a second wave of debt cancellation began in the late 1980s (for details, see UNCTAD, The Least Developed Countries, 1993-1994 Report (United Nations publication, Sales No. E.94.II.D.4), pp. 24-27). Terms for rescheduling remaining ODA debts have been determined in the Paris Club.

3/ Paris Club treatments have been named after the places in which the treatments were proposed or endorsed. The first concessional treatment of non-concessional debt was agreed at the Toronto Summit of the Group of Seven in 1988. It was subsequently enhanced in 1991, after the London Summit of the Group of Seven called for relief "well beyond Toronto terms". The most widely discussed proposal for additional relief has been the "Trinidad terms", contained in a speech by the British Chancellor of the Exchequer at a Commonwealth Finance Ministers Meeting in Trinidad and Tobago in September 1990.

4/ These are the "Houston terms", named after the Houston Summit of the Group of Seven in 1990.

5/ See United Nations, World Economic and Social Survey, 1994 (United Nations publication, Sales No. E.94.II.C.1 and Corr.1), table A.35.

6/ Unlike the United Nations and IMF, the World Bank does not make separate statistical groupings of developing and transition economies, grouping them all instead as developing countries. Transition economies thus form part of the data set in table 2 and the associated discussion in the text.

7/ Classification in the earlier publication was based on data of 1988 and in the latter publication, data averaged over 1990-1992. The increased number of countries was not a consequence of a new classification methodology that the Bank introduced with the publication of the 1992-93 edition of the report. This is so because the critical ratios were chosen in order to ensure that the set of countries in a particular indebtedness category remained virtually the same for the year the transition to the new methodology was made.

8/ The 15 countries include only those which are currently part of the World Bank's debtor reporting system. Three countries on the new list were not reporters in the earlier period (Albania, Angola and Bulgaria), but based on available information, none of them would have appeared on the earlier list.

9/ The countries were Argentina, Bolivia, Brazil, Chile, Colombia, Côte d'Ivoire, Ecuador, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela and former Yugoslavia.

10/ Lack of data precluded measuring the degree of indebtedness of former Yugoslavia.

11/ World Debt Tables reported small amounts of arrears for Indonesia, Bangladesh, Barbados and Nepal. These countries, however, have not experienced any debt-servicing difficulty in recent years and are therefore excluded from the data set. The tables also reported small amounts of arrears for Bhutan and former Czechoslovakia in 1992; they as well are not counted since they are not known to have debt problems. Finally, while Kenya's arrears were insignificant in 1987, they were substantial in 1992; thus Kenya is counted as a country that was not a problem debtor in 1987, but became one in 1992.

12/ See IMF, World Economic Outlook (May 1994), p. 105.

13/ Estimates for 1994 by Population Division/DESIPA as per World Population Prospects, The 1994 Revision, preliminary release of statistical annex.

14/ See discussion and conclusion in "The international debt strategy as of mid-1993", report of the Secretary-General (A/48/345 of 9 September 1993).

15/ IMF, in particular, forecasts that its grouping of developing countries with recent debt difficulties, which was discussed above, will invest roughly 20 per cent of GDP through 1995, about the same as in the 1980s and a third less than the investment share of the group of countries without recent debt-servicing difficulties (see IMF, World Economic Outlook (May 1994), table A.43).

16/ World Bank, World Debt Tables, 1993-94, p. 7.

17/ IMF, World Economic Outlook (May 1994), p. 63.